

**Letter of Findings Number: 08-0557**  
**Use Tax**  
**For Tax Years 2005-06**

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**ISSUES**

**I. Use Tax—Imposition.**

**Authority:** IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-8.1-5-1.

Taxpayer protests the assessment of use tax.

**II. Tax Administration—Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer is an Indiana corporation involved in manufacturing. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax for the tax years 2005 and 2006. The Department issued proposed assessments for use tax, ten percent negligence penalties and interest. Taxpayer protests the imposition of use tax on some of the items which the Department determined tax was due. Taxpayer also protests the imposition of penalty. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Use Tax—Imposition.**

**DISCUSSION**

Taxpayer protests the imposition of use tax on some items included as taxable in the Department's audit report. The first category is items upon which sales tax was paid at the time of purchase. The second category is items which are used in the manufacturing process and are therefore exempt from sales tax. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The first category protested includes items upon which sales tax was paid. The use tax is imposed under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Next, IC § 6-2.5-3-4 states:

(a) The storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if:

- (1) the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property; or
- (2) the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24\(b\)](#), and the property is being used, stored, or consumed for the purpose for which it was exempted.

(b) If a person issues a state gross retail or use tax exemption certificate for the acquisition of tangible personal property and subsequently uses, stores, or consumes that property for a nonexempt purpose, then the person shall pay the use tax.

(Emphasis added).

At the time of the audit, the Department did not have documentation which established that Taxpayer had paid sales tax on these items. In the course of the protest process, Taxpayer provided documentation establishing that sales tax was paid on the items listed on lines two, three, and ten of page four of the audit report. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) and these items will be removed from the list of taxable items.

The second category protested includes items which Taxpayer states are exempt manufacturing equipment. The exemption is found under IC § 6-2.5-5-3, which states:

(a) For purposes of this section:

- (1) the retreading of tires shall be treated as the processing of tangible personal property; and
- (2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.  
(Emphasis added.)

As part of the protest process, Taxpayer provided documentation establishing that the items listed on line seven of page four of the audit report are exempt under IC § 6-2.5-5-3(b).

Taxpayer also protests that two fork lifts are exempt. A review of the documentation and analysis provided in the protest shows that one forklift is used to unload materials prior to the initial step in the production process. The other forklift is used to move materials from one station to another in the production process. As provided by IC § 6-2.5-5-3(b), equipment is exempt if it is directly used in the direct production process. The fork lift which is used for unloading is used in pre-production while the other fork lift, which moves materials between workstations, is directly used in the direct production process. The documentation provided in the protest shows that the fork lift listed on line twenty-two of page four of the audit report is exempt under IC § 6-2.5-5-3(b). The other fork lift is not exempt since it is used in pre-production.

In conclusion, Taxpayer has met the burden of proving that the items listed on lines two, three, seven, ten of page four of the audit report are not taxable. Also, the portion of the amount listed on line twenty-two of the audit report, which was for the fork lift used in production, is not taxable. The fork lift listed on line five of page four of the audit report is taxable. A supplemental audit will recalculate the use tax due after removing the exempt items listed above.

#### FINDING

Taxpayer's protest is sustained in part and denied in part.

#### II. Tax Administration–Negligence Penalty.

#### DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

#### FINDING

Taxpayer's protest is sustained.

#### CONCLUSION

Taxpayer is partially sustained and partially denied on Issue I. Taxpayer is sustained on Issue II. A supplemental audit will be conducted to reflect the findings listed above.

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